Supreme Court, U.S.
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No. _____

In the
SUPREME COURT OF THE UNITED STATES

October Term, 1994

John M. O'Quinn, *Petitioner*,

v.

Donna C. Kline, *Respondent.*

Petition for Writ of Certiorari to the
Court of Appeals of Texas, Houston [14th District]

PETITION FOR WRIT OF CERTIORARI

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April 10, 1995

QUESTIONS PRESENTED

1. Whether an arbitration award of punitive damages against Mr. O'Quinn in this case is unconstitutional in violation of the Due Process Clause of the Fourteenth Amendment.

2. Whether an arbitration award of punitive damages is generally unconstitutional in violation of the Due Process Clause of the Fourteenth Amendment, even if the parties expressly attempted to bestow that right upon the arbitrators.

3. Whether an express contractual waiver of the constitutional right to due process is required to allow an arbitrator to award punitive damages without violating the Due Process Clause of the Fourteenth Amendment.

4. Whether an arbitrators' decision to award punitive damages in a case in which the parties did not specifically agree that the punitive damages may be awarded in the arbitration proceeding and the complainant did not request punitive damages, is entitled to a deferential standard of review.

LIST OF ALL PARTIES

1. John M. O'Quinn, Petitioner herein, was a Defendant in the Trial Court, a Defendant in the Arbitration Proceeding, and an Appellee in the Fourteenth Court of Appeals.

2. Donna C. Kline, Respondent herein, was the Plaintiff in the Trial Court, the Plaintiff in the Arbitration Proceeding, and the Appellant in the Fourteenth Court of Appeals.

3. Thomas J. Pearson was a Defendant in the Trial Court and a Defendant in the Arbitration Proceeding. There was no appeal taken by Mr. Pearson to the Fourteenth Court of Appeals and Ms. Kline did not appeal as to Mr. Pearson. It is believed that the litigation between Ms. Kline and Mr. Pearson is now final and that Mr. Pearson is not involved in this proceeding.

4. Bank One, Texas, N.A. ("Bank One"), was a Defendant in the Trial Court, but not a party to the Arbitration Proceeding. Ms. Kline appealed to the Fourteenth Court of Appeals with respect to the Trial Court's Judgment as to Bank One. Bank One prevailed. It is believed that the litigation between Ms. Kline and Bank One is now final and that Bank One is not involved in this proceeding.

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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1994

John M. O'Quinn, *Petitioner*,

v.

Donna C. Kline, *Respondent.*

Petition for Writ of Certiorari to the
Court of Appeals of Texas, Houston [14th District]

Petitioner John M. O'Quinn respectfully petitions for a Writ of Certiorari to review the decision of the Fourteenth Court of Appeals of Texas, Houston.

OPINIONS BELOW

The *Arbitrators' Award* is not reported; however, a copy of the *Arbitrators' Award* is included as Appendix G and a copy of the Arbitrators' *Denial of Petitioner's Motion to Partially Modify and Vacate Arbitration Award* is included as Appendix H. The Trial Court reviewed the *Award* and entered *Final Judgment* vacating the portion of the arbitrators' *Award* that purported to impose punitive damages on Mr. O'Quinn. The Trial Court's *Final Judgment* is not reported; however, a copy is included as Appendix F. A three-judge panel of the Fourteenth Court of Appeals of Texas, with one dissent, affirmed in part and reversed and rendered in part. This decision of

the Court of Appeals is reported at 874 S.W.2d 776. The *Majority Opinion* for such decision is included as Appendix A; the *Dissenting Opinion* is included as Appendix B; and the *Opinion* of the Fourteenth Court of Appeals responsive to the parties' *Motions for Rehearing*, which *Opinion* supplemented the original opinions and modified the original decision but otherwise denied rehearing, is included as Appendix C. The Texas Supreme Court declined to review the decision of the Fourteenth Court of Appeals. The Texas Supreme Court's denial of Petitioner's *Application for Writ of Error* is reported at 38 Tex. Sup. Ct. J. 100 (December 1, 1994) and a copy is included as Appendix D. The Texas Supreme Court's overruling of Petitioner's *Motion for Rehearing* is reported at 38 Tex. Sup. Ct. J. 159 (January 12, 1995) and a copy is included as Appendix E.

JURISDICTION OF THIS COURT

The Texas Court of Appeals issued its opinion in this case on March 24, 1994, and ruled on the parties' *Motions for Rehearing* on May 12, 1994. The Texas Supreme Court denied Mr. O'Quinn's *Application for a Writ of Error* on December 1, 1994, and denied Mr. O'Quinn's *Motion for Rehearing* on January 12, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS AND FEDERAL STATUTES PRESENTED IN THIS CASE

The Fourteenth Amendment to the United States Constitution provides in part: "nor shall any State deprive any person of life, liberty, or property, without the due process of law. * * *"

The Federal Arbitration Act, 9 U.S.C. § 10, provides in part, "(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration -- (4) the arbitrators exceeded their powers. . ."

STATEMENT OF THE CASE

This dispute arises out the arbitration of a contract dispute among lawyers over the allocation of contingent fees from various lawsuits or cases. Although Ms. Kline did not seek punitive damages, and there was no notice that punitive damages might be in issue in the Arbitration Proceeding, and Texas law does not allow the award of punitive damages under the facts of this dispute, the Arbitrators attempted to award punitive damages. The Trial Court then correctly entered *Final Judgment* in the amount of the actual damages awarded by the Arbitrators but modified and partially vacated the Award to set aside the punitive damages the Arbitrators had improperly attempted to award. Ms. Kline appealed. The Texas Fourteenth Court of Appeals then modified the Trial Court's *Final Judgment* to award punitive damages against Mr. O'Quinn. The Texas Supreme Court declined to hear the case.

In the mid-80's, Mr. O'Quinn entered into an agreement with an attorney named Don Maierson with respect to certain toxic tort cases. Under their agreement, Mr. O'Quinn was to receive 45% of any fees recovered in the cases, with Mr. Maierson to use the other 55% to pay himself and the other attorneys working on the cases. On March 1, 1988, Ms. Kline, Mr. O'Quinn, and Mr. Pearson entered into an agreement by which Mr. O'Quinn would

fund and assist in certain toxic tort cases. Later, Ms. Kline, Mr. O'Quinn, and Mr. Pearson entered into a second agreement dated January 20, 1989 detailing their understanding of how the fees from such cases were to be allocated. Each of these agreements specified it would be governed by Texas law. As a result of various settlements in the lawsuits covered by the above agreements, sums were received for the clients and attorney's fees were recovered.

In early 1991, Ms. Kline filed suit against Mr. O'Quinn, Mr. Pearson, and Mbank (now Bank One). claiming that they owed her additional attorney's fees from the settlements of certain of these lawsuits. In her *Plaintiff's Original Petition*, a copy of which is included in Appendix J beginning at J-4. Ms. Kline sued Mr. O'Quinn and Mr. Pearson; Bank One was named in Ms. Kline's lawsuit, but no claim was made against Bank One. Ms. Kline alleged that Mr. O'Quinn and Mr. Pearson were in breach of their contractual obligations regarding the allocation of attorney's fees. Although her lawsuit was to recover monies that she claimed she was owed under the agreements, Ms. Kline also alleged that Mr. O'Quinn and Mr. Pearson breached an alleged tort duty of good faith and fair dealing and had assumed the duties of fiduciaries and had breached a fiduciary duty. Mr. O'Quinn answered and denied all wrongdoing.

The agreements among Ms. Kline, Mr. O'Quinn, and Mr. Pearson provided for arbitration. Therefore, after filing suit, Ms. Kline filed a *Demand For Arbitration* with the American Arbitration Association, a copy of which is included as Appendix I, initiating Arbitration Proceeding No. 70 194 0030 91 W. Ms. Kline's *Demand For Arbitration* described the dispute as a "disagreement

among attorneys over contingent fee recoveries." Ms. Kline also submitted her *Plaintiff's Original Petition* to the AAA, together with an explanatory letter, which noted that the *Plaintiff's Original Petition* "states Ms. Kline's position on the matters and controversy more clearly than the papers previously submitted" to the AAA. Neither Ms. Kline's *Demand For Arbitration* nor her *Plaintiff's Original Petition* made any request for an award of punitive damages. In her Prayer in her *Plaintiff's Original Petition*, Ms. Kline requested only actual damages, attorney's fees, pre-judgment and post-judgment interest, and a declaration of the rights and duties of the parties with respect to each other.

The arbitration hearing was held in May 1992. On June 23, 1992, the arbitrators issued their *Award of Arbitrators.* A copy of the *Award* is included as Appendix G. The Arbitrators awarded Ms. Kline compensatory damages against Mr. O'Quinn, plus pre-Award and post-Award interest. Additionally, even though Ms. Kline had not pled for punitive damages and Mr. O'Quinn had no notice until after the close of the evidence that Ms. Kline might even seek punitive damages in the Proceeding, the Arbitrators decided that Mr. O'Quinn should pay Ms. Kline $50,000 in exemplary damages.

Because the *Arbitrators' Award* improperly purported to assess punitive damages against him, Mr. O'Quinn timely sought review of the *Award* by the Arbitrators themselves pursuant to the Texas General Arbitration Act. The arbitrators denied Mr. O'Quinn's *Motion*. A copy of the arbitrators' denial of such *Motion* is included as Appendix H.

The parties specified in their agreements that Texas law would govern the dispute. As such, it was believed at the time that even though the Federal Arbitration Act may be applicable to this dispute, under ***Volt Information Sciences v. Board of Trustees***, 489 U.S. 468 (1989), the procedural aspects of the Texas General Arbitration Act should be followed. Thus, Ms. Kline filed with the Trial Court a pleading entitled an *Application for Decree* by which she sought to confirm the arbitrators' *Award*. Mr. O'Quinn opposed Ms. Kline's *Application for Decree*; a copy of Mr. O'Quinn's *Opposition to Kline's Application for Decree* is included as Appendix O. In accordance with the provisions of the Texas General Arbitration Act, Mr. O'Quinn also timely filed with the Trial Court his *Motion to Vacate, or, Alternatively, Modify and Correct the Award*, a copy of which is included as Appendix P.

The Trial Court held a series of hearings over the next few months regarding the issues raised by Mr. O'Quinn's *Motion to Vacate, or, Alternatively, Modify and Correct the Award* and by Mr. O'Quinn's opposition to Ms. Kline's *Application for Decree*. From the very first hearing on October 2, 1992, the Trial Court held that she was going to modify the arbitrators' *Award* to vacate the portion in which the arbitrators attempted to impose exemplary damages on Mr. O'Quinn. The Trial Court stated, however, that she would not enter a *Final Judgment* confirming the actual damages awarded by the arbitrators and vacating the exemplary damages until such time as Ms. Kline's claims against Bank One were also resolved. The Trial Judge said there would not be multiple appeals from this complex dispute. Ms. Kline then amended her pleadings to allege claims against Bank One and the Trial Court set the case for trial.

Ms. Klines proceeded to trial against Bank One on December 21, 1992. At the close of Ms. Kline's case in chief on September 28, 1992, Bank One moved for a directed verdict. The Trial Judge granted Bank One's motion.

On January 4, 1993, the Trial Court then entered its *Final Judgment* on January 4, 1993. In her *Final Judgment*, included as Appendix F, the Trial Court held that the arbitrators purported award of punitive damages failed to conform either to the parties' arbitration agreement or to the relief sought by Ms. Kline, and that the arbitrators exceeded the scope of their authority in attempting to award punitive damages against Mr. O'Quinn. *See* Paragraph 1 at F-3. Mr. O'Quinn subsequently paid the Trial Court's *Judgment*.

Ms. Kline appealed from the *Final Judgment* with respect to the Trial Court's vacating of the punitive damages. Ms. Kline also appealed as to the Trial Court's rulings that Mr. O'Quinn was not required to pay post-award attorneys fees and that Ms. Kline was not entitled to a separate trial on the issue of punitive damages. Ms. Kline also appealed as to Bank One.

The Texas Court of Appeals held that the trial court incorrectly modified the *Arbitrator's Award* to vacate the award of punitive damages. The Court of Appeals affirmed the Trial Court's *Final Judgment* that Mr. O'Quinn was not required to pay post-award attorneys fees and that Ms. Kline was not entitled to a separate trial on the issue of punitive damages and as to Bank One. Both Mr. O'Quinn and Ms. Kline asked the Texas Supreme Court to hear the case, but the Texas Supreme Court declined to do so.

Pursuant to Rule 14(h) of this Court's Rules, it is noted that the federal questions sought to be reviewed were presented to the Trial Court in a series of hearings extended from October 2, 1992 through December 18, 1992. Issues were raised through formal pleadings, through letters to the Trial Judge, and through oral arguments. Mr. O'Quinn raised before the Trial Court the issue that the award of exemplary damages by the arbitrators violated his rights afforded by the Due Process Clause of the United States Constitution. Mr. O'Quinn specifically raised the issue of lack of Due Process in his *Opposition to Kline's Application for Decree*, *see* Appendix O, Paragraph 9 at pages O-6 and O-7 and Paragraph 17 at page O-11 and also in his *Motion to Vacate, or, Alternatively, Modify and Correct Arbitration Award*, *see* Appendix P, Paragraphs 10, 11, 12 and 13 at pages P-8 through P-10 and Paragraph 21 at P-15 and P-16.

In the Texas Fourteenth Court of Appeals, Mr. O'Quinn argued that the Due Process Clause of the United States Constitution requires that punitives damages be a sanction reserved to the courts where there are safeguards such as judicial review. The Fourteenth Court of Appeals of Texas acknowledged that Mr. O'Quinn had raised the issue of whether lack of notice violated Due Process, *see* 874 S.W.2d at 784 and Appendix A at A-12, but stated that Mr. O'Quinn waived the other constitutional issue because it was not raised in the Trial Court. However, as discussed below, under Texas law Mr. O'Quinn did not need to raise this other constitutional issue before the Trial Court because the Trial Judge had from the outset held that the arbitrators exceeded their authority because their purported award of punitive damages failed to conform either to the parties' arbitration agreement or to the relief sought by Ms. Kline.

Because of the importance of the issues raised, Mr. O'Quinn requests that this Court grant his *Petition for Writ of Certiorari*.

I. Because arbitration proceedings fail to meet the constitutional requirements applicable to punitive damages, arbitrators generally should not be permitted to award punitive damages

A. This Court's decisions in *Oberg*, *Haslip*, and *TXO* demonstrate the constitutional requirements applicable to awards of punitive damages:

As this Court recently observed, punitive damages are "exceptional" in nature. ***Honda Motor Co. v. Oberg***, 114 S.Ct. 2331, 2340-2341 (1994); *see also* ***Pacific Mut. Life Ins. Co. v. Haslip***, 499 U.S. 1, 18 (1991) (expressing concern that unlimited jury discretion could allow punitive damages to "run wild").

This Court recently emphasized that Due Process requires judicial review of awards of punitive damages. ***Oberg*** at 2334. In ***Oberg***, the Court struck down an Oregon law which prohibited judicial review of the amount of punitive damages awarded by a jury. ***Id.*** at 2339. In reaching this conclusion, the Court emphasized the special nature of punitive damages and the "acute danger of arbitrary deprivation of property" from punitive damages. In addition, the Court emphasized that judicial review of punitive damages was "one of the few procedural safeguards which the common law provided against that danger."

This Court earlier has emphasized the importance of such procedural safeguards in the Court's cases leading to the ***Oberg*** decision. For example, in ***Pacific Mutual Life Ins. Co. v. Haslip***, 499 U.S. 1 (1991), this Court held that the traditional common law method for assessing punitive damages is not so inherently unfair as to deny Due Process and to be *per se* unconstitutional. The Court went on to hold, however, that unlimited jury discretion -- or unlimited judicial discretion for that matter -- in fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities. ***Id.*** at 18. The Court stated that the jury's discretion as to punitive damages is constitutional only when a trial court gives the jury reasonable and adequate guidance in making such awards. The Court noted that under Alabama law, as under the law of most states, punitive damages are imposed for purposes of retribution and deterrence, not to compensate the plaintiff for any injury. The Court observed that the instructions in ***Haslip*** informed the jury that its discretion should be guided by this purpose. ***Id.*** at 19.

Additionally, this Court in ***Haslip*** indicated that punitive damages are constitutional only when the instructions given to the jury describe the standards to be used by the jury in determining whether to impose such awards. Although juries are given significant discretion in assessing punitive damages, that discretion is not unlimited. In ***Haslip***, the Court found that the jury's discretion was confined by appropriate instructions about deterrence and retribution and the state policy concerns sought to be advanced. ***Id.*** at 19-20. The Court found that the jury was instructed that if punitive damages were to be awarded, the jury "must take into consideration the character and degree of the wrong as shown by the

evidence and necessity of preventing similar wrong." *Id.* at 19.

In ***TXO Production Corp. v. Alliance Resources Corp.***, 113 S. Ct. 2711 (1993), this Court again considered the limits imposed by Due Process on awards of punitive damages. The Court concluded that because West Virginia law requires that punitive damages bear a reasonable relationship to compensatory damages, the magnitude of the potential harm that defendant's conduct could have caused, as well as to the possible harm to the other victims that might have resulted if similar future behavior were not deterred, there was sufficient concern by the West Virginia trial courts with the reasonableness of the award such so as to meet the substantive requirements of the Due Process Clause. *Id.* at 2720-721.

Turning to the procedural component of the Due Process Clause, the Court indicated that the inquiry could include whether the punitive damages award is a result of a fundamentally unfair procedure because the jury was not adequately instructed, whether the award was adequately reviewed by the trial or appellate courts, and whether the defendant had no advance notice that the jury might be allowed to return such a large award or to rely on potential harm as a basis for its calculation. The Court declined to address the first argument as it was not argued or passed on below. The Court concluded that in fact the jury's award was adequately reviewed by the trial court and the appellate court and that defendant had notice under prior law that punitive damages could be awarded under the circumstances of the case. Thus, the Court found no procedural violation of Due Process as a result of the procedures used in West Virginia for the awarding of punitive damages. *Id.* at 2720-724.

B. The safeguards emphasized by this Court in *Oberg*, *TXO*, and *Haslip* are completely absent from arbitration proceedings generally:

There is nothing in an arbitration proceeding to ensure against excessive or otherwise inappropriate punitive damage awards. None of the protections -- not a single one -- discussed by the Court in ***Oberg***, ***Haslip*** and ***TXO*** is present in an arbitration proceeding. There is no voir dire of the potential arbitrators to determine their biases against the defendant or their feelings as to the award of punitive damages. Discovery is abbreviated, which can result in the defendant being denied the opportunity to develop the facts necessary to refute the plaintiff's allegations. There are few evidentiary rules applicable to an arbitration proceeding; virtually everything is admissible into evidence. Hence, there is no procedure for controlling and limiting the evidence submitted to the Arbitrators and the statements made by the parties and their advocates to the Arbitrators. Virtually anything can be done or said during an arbitration hearing -- and apparently was in this case.

There is no procedure whereby the arbitrators are provided, either by the trial court or the American Arbitration Association or some other supervising organization, instructions that articulate the purposes of punitive damages. Unlike juries, arbitrators are not instructed that punitive damages are to punish and to deter the defendant, nor are arbitrators instructed as to when and under what circumstances the law allows the award of punitive damages.

Because punitive damages are so subjective, the United States Constitution requires judicial supervision by the trial or appellate courts. However, one of the underlying theories of arbitration is that there should be minimal court review and supervision. Indeed, the Texas Court of Appeals in this case deferred to the arbitrators as to "procedural matters such as the sufficiency of Kline's pleadings" and then presumed "adequate evidence to support the award." *See* 874 S.W.2d at 783 and Appendix A at A-11. Because there is rarely a record of the arbitration proceedings, arbitrators sometimes choose not to state their reasoning or the bases for their decision, making it is almost impossible for reviewing courts to supervise the proceedings or the arbitrators' award. While this may seem acceptable for compensatory damages, allowing arbitrators to award *punitive* damages will lead to unpredictable, uncontrollable, nonreviewable awards of punitive damages.

There is no procedure applicable to arbitration awards for the trial court or the appellate courts to review the testimony and documents considered by the arbitrators or the basis on which the arbitrators made their award of punitive damages. Similarly, there is no procedure for the trial court or the appellate court to determine whether the award of punitive damages by the arbitrators is excessive taking into account the factors articulated by this Court in the ***Oberg***, ***Haslip***, and ***TXO*** decision.

Even before this Court's decision in ***Oberg***, there were some who questioned whether arbitrators could award punitive damages without violating due process. One judge summarized the situation as follows:

> Finally, ***Haslip*** is about due process and the protections that must be employed for punitive damages to be permissible in any event. In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this form of punishment. Discovery is abbreviated if available at all. The rules of evidence are employed, if at all, in a very relaxed manner. The factfinders (here the panel) operate with almost none of the controls and safeguards assumed in ***Haslip***. The proceeding at issue in ***Haslip*** was conducted in the Alabama state court system with full appellate review. Here, as noted by the opinion of the court, the scope of review of the arbitrator's award is narrowly limited if not almost nonexistent.
>
> This standard of review, of course, almost completely ignores the review required by ***Haslip***. Why should less be required in an arbitration proceeding if, indeed, punitive damages are within the scope of AAA Rule 43? The simple answer is that the rules doe not contemplate an award of punitive damages. The district court was correct and should be affirmed.

Lee v. Chica, 983 F.2d 883, 889 (8th Cir. 1993) (Beam, J., concurring in part and dissenting in part); *see also* Ira P. Rothken, *Punitive Damages in Commercial Arbitration: A Due Process Analysis*, 21 GOLDEN GATE UNIV. L. REV. 387, 397-404 (1991) (concluding that arbitration awards of punitive damages violate due process).

C. This Court's decision in *Mastrobuono* highlights the importance of the issues presented:

Earlier this Term, this Court upheld an arbitrators' award of punitive damages under the Federal Arbitration Act. In ***Mastrobuono v. Shearson Lehman Hutton***, 115 S.Ct. 1212 (1995), this Court upheld the award of punitive damages under the Federal Arbitration Act even though the parties' contract contained a choice-of-law provision specifying the application of New York law, which prohibits arbitrators from awarding punitive damages. In ***Mastrobuono***, the Court indicated that if the parties' intent is clear as to whether the arbitrators may award punitive damages, the intention of the parties will be upheld, even if a rule of State law would otherwise exclude such claims from arbitration. ***Id.*** at 4197. *See also* ***Southland Corp. v. Keating***, 465 U.S. 1 (1984), and ***Perry v. Thomas***, 482 U.S. 483 (1987). The Court indicated that if the arbitration provision in issue unequivocally excludes punitive damage claims, such claims are to be excluded from the arbitration process. *See also* ***Mitsubishi v. Soler Chrysler-Plymouth***, 473 U.S. 628 (1985). However, to the best of Petitioner's knowledge, the Due Process issues presented in this case were not raised before this Court in ***Mastrobuono*** or any other prior decision of this Court involving an award by arbitrators of punitive damages.

Clearly, an arbitration proceeding performs a function that is and has been a traditionally exclusive function or prerogative of government. This is particularly so when arbitrators award punitive damages. In ***Edmonson v. Leesville Concrete Co.***, 500 U.S. 614, 625 (1991), this Court, citing ***Haslip***, observed that "the jury can weigh the gravity of a wrong and determine the degree of the government's interest in punishing and determining wilful misconduct."

Edmonson at 625. If Due Process requires judicial review of awards of punitive damages by juries and courts, as this Court held in ***Oberg***, surely Due Process applies to the arbitration process and requires judicial review of awards of arbitrators.

The tension between ***Oberg***, which requires judicial review of jury awards of punitive damages, and ***Mastrobuono***, which suggests deference to an arbitrators' award of punitive damages, will continue. Given the absence of the traditional common law procedures in an arbitration proceeding, together with the widespread use of arbitration, the issues raised in this Petition for Certiorari are likely to come before the courts over and over. This Court, through a decision in this case, can firmly establish an appropriate rule applicable to such cases.

II. Contracting parties do not waive their Due Process rights simply by agreeing to arbitrate unless they expressly agree to allow arbitrators to award punitive damages:

Arbitration is entirely consensual. Unless there is a *contract* containing an arbitration provision, there is no arbitration. *Contracting* parties elect to submit their future disputes to arbitration for the purpose of a private, speedy and fair resolution, without the delays and rigidities of a court trial. They expect their arbitrators to award the type of relief that the law allows for breach of *contract*. They do not expect the arbitrators to award punitive damages, particularly when the law does not allow the recovery of punitive damages for *breach of contract*. *E.g.*, ***International Union of Operating Engineers,***

Local No. 450 v. Mid-Valley, Inc., 347 F. Supp. 1104, 1109 (S.D. Tex. 1972).

It is one thing for *contracting* parties to submit to arbitration the issue of *contractual* **compensatory** damages, which are largely based on objective criteria. But **punitive** damages are entirely different. Punitive damages are quasi-criminal and subjective in nature. As stated by the Court in ***Oberg***, the jury discretion that is the hallmark of the common law punitive damage system **must** be complemented by procedural safeguards that will ensure against excessive or otherwise inappropriate awards. When parties submit their *contractual* disputes to arbitration, they should not risk having punitive damages awarded against them without any safeguards to ensure against excessive or inappropriate punitive damage awards.

Parties do not "waive" their fundamental substantive and procedural rights simply by agreeing that their future *contract* disputes will be resolved by arbitration. As one federal court in Texas explained:

> Contracting parties do not normally agree to assess exemplary damages for a breach of contract. Such damages being punitive in nature are rare in contract law. Contractual consent to so drastic a "remedy" for simple breach cannot be implied. **Therefore, a arbitrator's assessment of punitive damages must be grounded in express language.** In this case, neither the contract clause nor the simple question submitted suggest authority for exemplary damages.

Mid-Valley, 347 F. Supp. at 1109 (emphasis added). Under this approach, arbitrators may award punitive

damages only if expressly allowed by the parties' agreement. The view adopted in ***Mid-Valley*** is entirely consistent with the few Texas cases on point. In ***Grissom v. Greener & Sumner Constr. Co.***, 676 S.W.2d 709 (Tex. App. -- El Paso 1984, writ ref'd n.r.e.), for example, the parties expressly agreed to submit contract and tort claims, and all pending claims for damages, including punitive damages, to arbitration.

In addition to the above, there are additional reasons for requiring the parties' "express consent" to allow arbitrators to award punitive damages. For one thing, the exceptional and quasi-criminal nature of punitive damages weighs heavily in determining whether there has been a waiver of Due Process rights. In connection with a contractual waiver of Due Process rights (which protect against criminal penalties), the U.S. Constitution requires that the waiver be voluntarily, intelligently, and knowingly made. *See* ***Fuentes v. Shevin***, 407 U.S. 67, 94-95 (1972); ***D.H. Overmeyer Co. v. Frick Co.***, 405 U.S. 174, 185 (1972). Moreover, this Court has previously stated that it will "not presume acquiescence in the loss of fundamental rights." ***Ohio Bell Tel. Co. v. Public Utilities Comm'n***, 301 U.S. 292, 307 (1937). Instead, courts "indulge every reasonable presumption against waiver." ***Aetna Ins. Co. v. Kennedy***, 301 U.S. 389, 393 (1937).

Given the close connection between criminal law and punitive damages, the waiver standard applicable to other constitutional safeguards against criminal penalties should control the determination of whether a contracting party has waived his or her constitutional safeguards against an excessive award of punitive damages. As indicated in ***Oberg***, the special nature of punitive damages suggests

that a waiver of the Due Process safeguards against excessive punitive damages cannot be lightly inferred.

Although some courts flatly refuse to allow arbitrators to award punitive damages, *e.g.*, ***Garrity v. Lyle Stuart, Inc.***, 353 N.E.2d 793 (N.Y. 1976), other courts allow arbitrators to award punitive damages when the parties expressly agree that they may do so. In other words, these latter courts impose an "express consent" requirement before arbitrators may award punitive damages. *E.g.*, ***Edward Elec. Co. v. Automation, Inc.***, 593 N.E.2d 833, 842-43 (Ill. App. 1st Dist. 1992) (vacating severable award of punitive damages); ***Complete Interiors, Inc. v. Behan***, 558 So.2d 48, 50-51 (Fla. App. 5th Dist. 1990). In addition, numerous federal courts have considered this issue in the context of collective bargaining agreements and have concluded that arbitrators cannot award punitive damages absent an express agreement to that effect. *E.g.*, ***Howard P. Foley Co. v. International Brotherhood of Electrical Workers***, 789 F.2d 1421, 1424 (9th Cir. 1986); ***Baltimore Regional Joint Bd. v. Webster Clothes, Inc.***, 596 F.2d 95, 98 (4th Cir. 1979); ***Refinery Employees Union v. Continental Oil Co.***, 268 F.2d 447 (5th Cir. 1959); ***Westmoreland Coal Co. v. United Mine Workers***, 550 F. Supp. 1044, 1047-48 (W.D. Va. 1982); ***Mid-Valley***, *supra*, 347 F. Supp. at 1109-10.

Applying an express consent rule in this case requires a reversal of the Fourteenth Court of Appeal's decision below and affirmation of the Trial Court's *Final Judgment*. As set forth in the Court of Appeal's opinion, the arbitration clause failed to expressly allow arbitration of punitive damages, let alone any express reference to tort claims. Under the express consent rule, the award of punitive damages exceeded the arbitrators' authority and was correctly set aside by the trial court. *See* TEX. REV. CIV.

STAT. ANN. art. 237 & 238 (Vernon 1973) (requiring the court to vacate or modify an arbitration award where the arbitrators exceed their authority or have awarded on a matter not submitted).

A rule disallowing punitive damages in arbitration unless the parties have expressly agreed otherwise is consistent with the constitutional limitations of ***Oberg***, ***TXO***, and ***Haslip***, yet is also consistent with ***Mastrobuono*** and the express consent cases cited above. It is unrealistic to assume that when parties agree to arbitrate future disputes arising out of their contract they thereby intend to "waive" all of the various constitutional protections afforded by the law in the absence of any express wording to that effect.

III. The arbitration proceedings at issue in this case were even worse than usual in terms of the absence of Due Process safeguards against punitive damages and violated Mr. O'Quinn's Due Process rights:

Due Process of law must apply in arbitration proceedings just as in other legal proceedings. In this case, Ms. Kline's pleadings and submission to the arbitrators gave O'Quinn absolutely no notice of any claim for punitive damages. Ms. Kline's counsel submitted the *Plaintiff's Original Petition* to the AAA as the definition of Ms. Kline's claim. In her *Plaintiff's Original Petition*, Ms. Kline alleged breach of contract, breach of an alleged tort duty of good faith, and breach of an alleged fiduciary duty. Ms. Kline pled and prayed only for actual damages, *i.e.*, economic losses. Ms. Kline did not plead or pray for exemplary damages. Indeed, there is no mention -- not one single word -- in the *Plaintiff's Original Petition* about exemplary damages.

This case illustrates a key problem with arbitration -- the arbitrators may, either inadvertently or intentionally, enter an award clearly contrary to the law, yet that award might be upheld. Texas law simply does not allow the recovery of punitive damages for breach of contract, even if the breach is intentional, willful, and malicious. *See, e.g.,* ***Bellefonte Underwriters Ins. Co. v. Brown***, 704 S.W.2d 742, 745 (Tex. 1986); ***Amoco Prod. Co. v. Alexander***, 622 S.W.2d 563, 571 (Tex. 1981).

The Texas Supreme Court has held that in order to recover punitive damages attendant to a contract dispute a claimant must both (1) plead and (2) prove: (a) the commission of a separate tort, and (b) that the claimant sustained separate actual damages as a result of that separate tort. *See, e.g.,* ***International Bank, N.A. v. Morales***, 736 S.W.2d 622, 624 (Tex. 1987). Simply alleging, as Ms. Kline did, that the defaulting party to a contract allegedly also breached some tort duty, *e.g.*, a fiduciary duty or an implied duty of good faith and fair dealing, will not suffice. There must also be pleading and proof that the separate and distinct tortious conduct caused the claimant to sustain separate and distinct actual damages in tort. It is only the separate actual damages in tort that will support a claim for exemplary damages. *See, e.g.,* ***International Bank***, 736 S.W.2d at 624.

Interestingly, the Fourteenth Court properly held that Mr. O'Quinn owed no fiduciary duty to Kline. *See* 874 S.W.2d at 786-787 and Appendix A at pages A-18 through A-20. Moreover, Justice Ellis clearly pointed out in his dissent that Mr. O'Quinn owed no tort duty of good faith and fair dealing. *See* S.W.2d 874 at 789 and Appendix B at pages B-5 and B-6. The only other claim submitted to arbitration was Kline's *contract* claim. Texas law clearly

prohibits an award of punitive damages for mere breach of contract. But that is exactly the result of the Court of Appeals' decision.

Moreover, even if Ms. Kline had actually pled and proved that she was seeking to recover punitive damages based on separate actual damages in tort sustained as a result of breach of an alleged duty of good faith and fair dealing and/or an alleged fiduciary duty, she still would not be entitled to punitive damages. Neither a breach of the duty of good faith and fair dealing nor a breach of a fiduciary duty by itself entitles the injured party to punitive damages. In order to recover exemplary damages for breach of the duty of good faith and fair dealing or breach of fiduciary duty, a complainant must also plead and prove and obtain the additional finding of fraud, malice, or gross negligence. *See* TEX. CIV. PRAC. & REM. CODE § 41.003 (Vernon Supp. 1993); ***Arnold v. Nat'l County Mutual Fire Ins. Co.***, 725 S.W.2d 165, 168 (Tex. 1987); ***Manges v. Guerra***, 673 S.W.2d 180, 184 (Tex. 1984); ***Transportation Ins. Co, v, Moriel***, 879 S.W.2d 10 (Tex. 1994).

It appears that Ms. Kline requested punitive damages only at the conclusion of the arbitration proceedings and only after all of the evidence had been presented. It appears that Ms. Kline only then requested punitive damages and did so in a post final hearing brief. In such a situation, the arbitrators' award of punitive damages cannot stand because it exceeded their authority and constitutes an award on a matter not submitted. *See* TEX. REV. CIV. STAT. ANN. art. 237(A)(3) (award to be vacated when arbitrators exceed their authority) and art. 238(A)(2) (award to be modified when arbitrators award on a matter not submitted). Even if the Federal Arbitration Act supplies the governing law in accordance with

this Court's recent decision in ***Mastrobuono***, the Federal Arbitration Act, 9 U.S.C. § 10, provides for the vacating of the award when the arbitrators exceeded their powers.

The Texas Court of Appeals refused to examine the submissions to the arbitrators and simply *deferred* to their judgment. This approach shows a complete absence of judicial review, as is required under ***Oberg***. The injustice of the decision below is underscored when one considers the Court of Appeals' conclusion that Mr. O'Quinn had no fiduciary duty to Ms. Kline. As the dissent pointed out, the Court of Appeals rejected any possible legal basis for an award of punitive damages. *See* 874 S.W.2d at 788 and Appendix B. Nonetheless, the Court of Appeals' deference to the arbitrators and its refusal to review the award led it to reinstate an award of punitive damages which, by its own analysis, had absolutely no legal basis.

IV. The decision by the arbitrators to award punitive damages in a case where the parties did not specifically agree that the punitive damages may be awarded in the arbitration proceeding and the complainant did not request punitive damages should not be entitled to a deferential standard of review:

As stated above, the Fourteenth Court of Appeals in essence avoided all of the Due Process requirements of the United States Constitution and the requirements of Texas state law for the awarding of punitive damages by applying a deferential standard of review of the arbitrators' award. For example, the Texas Court of Appeals in this case deferred to the arbitrators as to "procedural matters such as the sufficiency of Kline's pleadings" and then presumed "adequate evidence to support the award." *See* 874 S.W.2d at 783 and Appendix A at A-11.

Similar to the issues under consideration at this time by this Court in ***Kaplan v. First Options of Chicago, Inc.***, 19 F.3d 1503 (3rd Cir. 1994), *cert. granted*, 115 S.Ct. 634 (1994), Mr. O'Quinn respectfully submits that reviewing courts should independently decide whether an arbitration panel has jurisdiction over the merits of any particular dispute. In a case where the parties did not specifically agree that the punitive damages may be awarded in the arbitration proceeding and the complainant did not request punitive damages, the arbitrators' award of punitive damages should not be entitled to a deferential standard of review. Indeed, this Court's holding in ***Oberg*** strongly suggests that, at least when arbitrators attempt to award punitive damages, Due Process requires judicial review of the arbitrators' authority to do so.

V. Mr. O'Quinn did not waive his right to present these important issues to this Court:

As a general rule, federal questions arising in State court must be properly set up and denied in the State court pursuant to State law in order to be reviewed by this Court. *See, e.g.*, ***Louisville & Nashville R.R. Co. v. Woodford***, 234 U.S. 46, 51 (1914). If the federal question was properly raised, then this Court's jurisdiction is not defeated merely because the highest court of the State declined to review the case. *See, e.g.*, ***Erie R.R. Co. v. Purdy***, 185 U.S. 148, 154 (1902).

The Texas Court of Appeals acknowledged that Mr. O'Quinn raised below the issue of whether lack of notice as to punitive damages violated his Constitutional right to Due Process. *See* 874 S.W.2d at 784 and Appendix A at A-12. The Court of Appeals in effect held that Mr. O'Quinn "waived" his Constitutional rights of Due Process by signing a contract containing an arbitration provision -- although the arbitration provision said nothing of any such waiver and did not bestow on the Arbitrators the right to award punitive damages. The Fourteenth Court of Appeals then declined to address Mr. O'Quinn's remaining Constitutional arguments on the basis that these arguments were not raised before the Trial Court. The Court of Appeals was incorrect on both counts.

First, under Texas law, Mr. O'Quinn was not required to raise his Constitutional arguments before the Trial Court. Mr. O'Quinn prevailed in the Trial Court. Ms. Kline, not Mr. O'Quinn, was the party who appealed from the Trial Court's *Final Judgment*. Under Texas law, as the prevailing party in the Trial Court and as the appellee in the Court of Appeals, Mr. O'Quinn was not required to argue to the Trial Court every alternative theory on which the Trial Court could have based its decision. ***Williams v. Khalaf***, 802 S.W.2d 651, 658 (Tex. 1990); ***Boyce Iron Works, Inc. v. Southwestern Bell Tel. Co.***, 747 S.W.2d 785, 787 (Tex. 1988). The Texas Supreme Court's decisions make it clear that an appellee has not waived an alternative basis for supporting the trial court's decision simply because Mr. O'Quinn, the <u>appellee</u> in the Court of Appeals, did not make the alternative argument in the Trial Court.

The proceedings below demonstrate why Mr. O'Quinn was not required to raise every possible argument before the Trial Court. At the first hearing involving the arbitration award, the Trial Court ruled from the bench in favor of Mr. O'Quinn. The Trial Court reaffirmed this ruling on several occasions, including at the pretrial conference. Given the Trial Court's rulings, there was no reason for Mr. O'Quinn to assert additional and alternative arguments to support the Trial Court's ruling. Doing so would have wasted the Trial Court's time, as the judge had already ruled. As in ***Williams*** and in ***Boyce Iron Works***, Mr. O'Quinn remained free to raise these alternative grounds for the Trial Court's ruling on appeal. Mr. O'Quinn did just that. Because these additional grounds for affirmance involve fundamental Due Process rights under the United States constitution, it is important for this Court to resolve these issues.

As authority for its conclusion that Mr. O'Quinn waived his Constitutional arguments, the Fourteenth Court cited ***Johnson v. Lynaugh***, 800 S.W.2d 936, 939 (Tex. App. -- Houston [14th Dist.] 1990, writ denied). However, ***Johnson*** involved waiver by an appellant, not an appellee. As noted, however, Mr. O'Quinn was the appellee. Mr. O'Quinn respectfully submits that ***Johnson*** simply does not apply here. Instead, ***Williams*** and ***Boyce Iron Works*** apply.

Second, Mr. O'Quinn in fact raised the issue of Due Process. Mr. O'Quinn raised before the Trial Court the issue that the award of exemplary damages by the arbitrators violated his rights afforded by the Due Process Clause of the United States Constitution. As noted above, Mr. O'Quinn specifically raised the issue in his *Opposition to Kline's Application for Decree*, *see* Appendix

O, Paragraph 9 at pages O-6 and O-7 and Paragraph 17 at page O-11, and his *Motion to Vacate, or, Alternatively, Modify and Correct Arbitration Award*, *see* Appendix P, Paragraphs 10, 11, 12 and 13 at pages P-8 through P-10 and Paragraph 21 at P-15 and P-16. Indeed, The Fourteenth Court of Appeals of Texas acknowledged that Mr. O'Quinn had raised the issue of whether lack of notice violated Due Process, *see* 874 S.W.2d at 784 and Appendix A at A-12.

In the Texas Court of Appeals, Mr. O'Quinn argued that the Due Process Clause of the United States Constitution requires that punitive damages be a sanction reserved to the courts where there are safeguards such as judicial review. *See* Mr. O'Quinn's *Brief of Appellee* filed with the Fourteenth Court of Appeals at Appendix K, pages K-14 through K-23. See Mr. O'Quinn's *Motion for Rehearing* filed with the Fourteenth Court of Appeals at Appendix L, pages L-17 through L-34. Mr. O'Quinn also submitted such issue to the Texas Supreme Court. *See Application for Writ of Error* at Appendix M, pages M-11 through M-21. *See Motion for Rehearing on Application for Writ of Error* at Appendix N, pages N-2 through N-5.

VI. Conclusion:

In this case, Due Process was violated. None of the Constitutional safeguards required by this Court with respect to the award of punitive damages, and the subsequent review of a punitive damages award, are found in an arbitration proceeding. For constitutional reasons, arbitrators should not be allowed to award punitive damages -- particularly in situations where the parties have not expressly authorized them to do so. If this Court allows arbitrators in situations such as this to award

punitive damages where the claimant did not seek punitive damages, and there was no notice that punitive damages might be in issue in the Arbitration Proceeding, and Texas law clearly does not allow the award of punitive damages under the facts of this dispute, all legal principles and the Constitutional safeguards applicable to the award of punitive damages will be circumvented through the arbitration process.

Contracting parties elect to submit their disputes to arbitration for the purpose of a private, speedy and fair resolution, without the delays and rigidities of a court trial. They expect the arbitration of their contractual disputes arising out of the contract. They do not expect the arbitrators to award punitive damages for breach of contract, particularly when the law does not allow the recovery of punitive damages for such a claim.

It is one thing for contracting parties to submit to arbitration the issue of contractual compensatory damages, which are largely based on objective criteria. But punitive damages are entirely different. They are subjective and take their shape from attitudes towards correction and reform. Because the award of punitive damages is so subjective, supervision by the courts is required. The need for supervision is heightened in arbitration proceedings because of the abbreviated discovery in arbitration (which can function to deny the defendant from developing the facts necessary to refute the plaintiff's allegations), the fact that arbitrators historically do not adhere to the rules of evidence and are willing to listen to anything, no matter how irrelevant, emotional and prejudicial, and because of the lack of any meaningful judicial review of arbitration awards.

Because one of the underlying theories of arbitration is that there should be minimal court review and supervision, allowing arbitrators to award punitive damages will lead to unpredictable, uncontrolled, and nonreviewable awards of punitive damages. This fails to comply with the requirements of the United States Constitution. Should this Court conclude that constitutional concerns do not require barring arbitrators completely from awarding punitive damages, those same concerns require that at the very least arbitrators may not award punitive damages except where the contracting parties have expressly granted them the authority to do so.

There is tension between ***Oberg***, which requires judicial review of jury awards of punitive damages, and ***Mastrobuono***, which suggests deference to an arbitrators' award of punitive damages. Given the absence of the traditional common law procedures in an arbitration proceeding, together with the widespread use of arbitration, the issues raised in this Petition for Certiorari are likely to repeatedly come before the courts. This Court, through a decision in this case, can establish an appropriate rule applicable to such cases.

The trial court's *Final Judgment* in this case eliminating the award of punitive damages against Mr. O'Quinn was entirely correct because the arbitrators were not authorized to award punitive damages. Mr. O'Quinn respectfully urges that the Court grant a Writ of Certiorari, reverse the decision of the Texas Court of Appeals, and affirm the Trial Court's *Final Judgment*.

Respectfully submitted,

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